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No. 134

IN THE

Supreme Court of the United States

October Term, 1955

CLARK SQUIRE, Collector of Internal Revenue for the District of Washington, *Petitioner*

v.

HORTON CAPOEMAN and EMMA CAPOEMAN, his wife

BRIEF IN OPPOSITION

To the Petition for Writ of Certorari

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TREATIES AND STATUTES INVOLVED

Treaty provisions and statutes involved are quoted in the appendix to the petition save those provisions of Art. I of the Treaty with the Quinaielt of July 1, 1855, and January 25, 1856, 12 Stat. 971, which disclose the Quinaielt habitat, the entire article reading as follows:

> ARTICLE I. The said tribes and bands hereby cede, relinquish, and convey to the United States all their right, title, and interest in and to the lands and country occupied by them, bounded and de-

scribed as follows: Commencing at a point on the Pacific coast, which is the southwest corner of the lands lately ceded by the Makah tribe of Indians to the United States, and running easterly with and along the southern boundary of the said Makah tribe to the middle of the coast range of mountains; thence southerly with said range of mountains to their intersection with the dividing ridge between the Chehalis and Quiniatl Rivers; thence westerly with said ridge to the Pacific coast; thence northerly along said coast to the place of beginning.

QUESTIONS PRESENTED

1. Is allotted land on the Quinaielt Indian Reservation, which has never been transferred free of restriction to the Indian allottee, subject to capital-gains tax upon its conversion by the United States into cash, notwithstanding the undertaking by the United States to transfer the land to him "free of all charge or incumbrance whatsoever"?

2. Is there a "basis" for capital-gain tax on the sale of timber growing on restricted, allotted Indian land held by the United States in trust and never, prior to the sale of the timber, transferred to the allottee without restriction, which basis is other or different than the proceeds realized by the United States to be held for the allottee?[1]

[1] The question of there being no capital asset, hence no basis, until the land (or the proceeds of its conversion) be transferred to the allottee free of all charge or incumbrance whatsoever was a ground of the decision of the District Court (see p. 11a of the petition). It was not expressly adverted to by the Court of Appeals. Even were it ruled against respondent in the Court of Appeals it would be open upon review of the merits in this Court, since its resolution in accordance with respondents' theory would support the judgment of the court below. *Langnes v. Green*, 282 U.S. 531, 538-9.

STATEMENT

When white men came to the Olympic Peninsula, they found the Quinaielt Tribe and their neighbors, the Quillehute, occupying a tract of country lying between the Coast Range and the ocean. This land (save for the reservation of certain lands for their exclusive use, Art. II), they ceded just a century ago to the United States by Treaty of July 1, 1855, and January 25, 1856, 12 Stat. 971, Art. I. It is on the reservation set up pursuant to this treaty that respondents—full blood Quinaielt Indians—live. R. 33, 34-35.

In the treaty it had been understood that the Quinaielts should have exclusive use of their reservation "and no white man shall be permitted to reside thereon without permission of the Tribe" (Art. II). But a new approach to the "Indian problem" resulted in the enactment of the General Allotment Act of 1887, c. 119, 24 Stat. 388, 25 U.S.C. § 331, *et seq.* Thereunder, Indians were to be allotted lands on their reservations not to exceed 160 acres of grazing land or 80 acres of agricultural land; and 25 years after allotment the allottees were to receive the lands discharged of the trust under which the United States had theretofore held them and to take a patent "in fee discharged of said trust and free of all charge or incumbrance whatsoever" (25 U.S.C. § 348)—though the President might extend the period. Still further change of policy with respect to the Indian problem (in 1934) has decreed that existing periods of trust or restriction on alienation are extended until otherwise directed by Congress. 25 U.S.C. § 462.

Under the General Allotment Act of 1887 petitioner was allotted 93.25 acres and received a trust patent

October 1, 1907 (R. 13, 35). The patent represents (R. 14) that the United States

> "does and will hold the land thus allotted (subject to all statutory provisions and restrictions) for the period of twenty-five years, in trust for the sole use and benefit of the said Indian, and that at the expiration of said period the United States will convey the same by patent to said Indian, in fee, discharged of said trust and free of all charge or incumbrance whatsoever, if the said Indian does not die before the expiration of the trust period; but in the event said Indian does die before the expiration of that period this patent and the allotment upon which it is based shall be canceled, and the said land shall revert to the United States and be thereafter disposed of in the manner prescribed by law."

The title continues to be held in trust (R. 35).

In 1943 standing timber on respondent Indian's allotment was cut, sold and paid for pursuant to a contract by the Bureau of Indian Affairs with the approval of respondents, the sales price being in the amount of $8,418.28 (R. 36). From this, $2,026.80—being the fair market value of the timber March 31, 1913, as determined by the forest ranger at Talolah Indian Agency (R. 20)—was deducted; together with $673.46 expenses of sale (R. 18), leaving a "gain" of $5,718.64, of which 50%, or $2,859.32, was taken into account (R. 18, 15-16) as a long-term capital gain in computing respondents' income tax for 1943. The tax computed on this theory was paid from the trust-fund proceeds in the hands of the Indian agency (R. 19-20) and respondent sued upon a timely claim for refund. (R. 20-22).

Judge Fee (110 F. Supp. 924, Appendix B to the petition herein, p. 8a) held respondents entitled to

recover. The United States having taken this property with the obligation to convey it at the end of the trust period to the allottee in fee "discharged of said trust and free of all charge or incumbrance whatsoever", it follows that until the allottee is put in possession of the land on those terms—namely, the whole corpus of the trust, which it has been agreed will be turned over to him free of all charge or incumbrance—the land cannot be treated as an ordinary "capital asset" for tax purposes. He pointed out that immediately on turning over to an Indian a patent in fee, the Indian receives a value greater than the March 1, 1913, value or the value on the date of the treaty; but if, thereupon, the Federal government taxed that increment, it would destroy the value of the trust property and violate its undertaking. Timber is a part of the land, and the proceeds of timber here are a substitute for the land itself. Merely by cutting the timber, the trustee does not relieve itself of the trust, or become entitled to help itself to proceeds of that which it had promised to put in the hands of respondents.

The Court of Appeals for the Ninth Circuit (Healy, Bone and Chambers, JJ.) affirmed *per curiam*, noting general agreement with Judge Fee and noting also that "this attempt to tax evidences, at the least, a sorry breach of faith with the Indians." It found no ground for the distinction which Judge Fee had supposed of the decision of the Tenth Circuit in *Jones v. Tannah*, 186 F. 2d 445, but expressly agreed with the dissenting opinion of Chief Judge Phillips in that case. 220 F. 2d 349. Petn. p. 13a.

ARGUMENT

1. There is no conflict with *Jones* v. *Taunah* (C.A. 10th, 1951), 186 F. 2d 445, cert. den. 341 U.S. 904. For the present case involves a so-called capital-gains tax, and the question whether there can be any "gain" where the undiminished, unincumbered corpus itself must be put in the hands of the government's ward. There is no "basis" in cost to the ward which is other or different than the proceeds of the sale of land (standing timber) involved here. But in the *Taunah* case no capital-gains situation was involved, but oil bonuses and royalties—which have never as to annual product been treated as involving capital gains at all, but carry their own formula for depletion, and thus in theory restore the basic capital itself at current values, as distinguished from the annual product of the land. In Taunah's case the government complied with its obligation to turn over to him either the land or the proceeds of the conversion of the land; this it did through the depletion allowance. But in the present case the tax collector has helped himself not to the mere annual product of the land, such as the annual growth of timber for the year of sale, but to a portion of the proceeds of sale which stand in place of the land itself.

This Court itself has marked the clear distinction between situations such as *Taunah*—in which the taxpayer gets back his capital at current rates through the depletion allowance—and the sale of a capital asset. Said this Court in *Anderson* v. *Helvering*, 310 U.S. 404, 407-8:

> * * * The production of oil and gas, like the mining of ore, is treated as an income-producing operation, not as a conversion of capital invest-

ment as upon a sale, and is said to resemble a manufacturing business carried on by the use of the soil. *Burnet* v. *Harmel*, 287 U.S. 103, 106-107; *Bankers Coal Co.* v. *Burnet*, 287 U.S. 308; *United States* v. *Biwabik Mining Co.*, 247 U.S. 116; *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 521, 522; *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 414. The depletion effected by production is likened to the depreciation of machinery or the using up of raw materials in manufacturing. *United States* v. *Ludey*, 274 U.S. 295, 302-303; *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, 370. Compare *Von Baumbach* v. *Sargent Land Co.*, supra, at 524-525. The deduction is therefore permitted as an act of grace and is intended as compensation for the capital assets consumed in the production of income through the severance of the minerals. *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366-367. The granting of an arbitrary deduction in the interests of convenience, of a percentage of the gross income derived from the severance of oil and gas, merely emphasizes the underlying theory of the allowance as a tax-free return of the capital consumed in the production of gross income through severance. *Helvering* v. *Twin Bell Oil Syndicate*, 293 U.S. 312, 321; *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 467."

See also *Helvering* v. *Elbe Oil Land Co.*, 303 U.S. 372, 375; *Badger Oil Co.* v. *Commissioner Int. Rev.*, (C.A. 5th, 1941), 118 F. 2d 791, 793.[2]

[2] In this last-cited case the Court of Appeals for the Fifth Circuit stated, with the citation of many authorities:

"* * * The allowance for depletion is intended to return to the owners of the oil reserve the loss of their capital which enters into the sale price of the oil produced. It deals with income realized by production. It has no application to sales in whole or in part of the capital investment, the oil reserve itself. * * *"

Nor should there be undue apprehension that the express note of conflict below will cause difficulty; for the court below also expressly agreed in the main with the opinion of Judge Fee, which discloses the distinction we have just delineated;[3] and the preference of the court below for the dissenting opinion of Chief Judge Phillips will not be of certiorari importance until and unless that time comes when in a depletion situation the Ninth Circuit court should follow the inclination here expressed.

The assertion of "conflict" with *Scott* v. *Commissioner*, 8 T.C. 126, ignores the fact that cases like that, and this, involving incompetent Indians on the Quinaielt Reservation, would be finally disposed of in the Ninth Circuit Court of Appeals. The *Scott* case was never appealed; and the present case represents the latest expression of the Ninth Circuit Court of Appeals on the subject.

2. It is asserted that the decision below is erroneous, petitioner citing four cases none of which involves conversion by the trustee of the land which it has agreed to deliver free from charge or encumbrance coupled with a levy on the proceeds which should stand in lieu of the land. While *Superintendent of Five Civilized Tribes* v. *Commissioner*, 295 U.S. 418,[4]

[3] "Judge Fee held (Petn., p. 11a), '. . . After the conveyance [of the land to the allottees free of trust], which must be authorized by the Indian in order to burden him with the weight of obligation, the national and state governments are empowered to tax this land and its increments as the real property of any other citizen. It follows that, until the land is thus conveyed, it cannot be treated as 'capital' or a 'capital asset'."

[4] "Income not from the restricted allotment but from investments made, in turn, from funds in excess of taxpayer's needs though originally derived from the allotment.

Choteau v. Burnet, 283 U.S. 691,[4] and the *Oklahoma Tax Commission* cases (326 U.S. 342, 353,[5] footnote 21, and 319 U.S. 598[6]) do indeed dissipate the popularly-held fallacy that Indians are not taxable and pay no taxes, none of them intimates that the United States will not honor its trust through holding either the land or its proceeds at current rates for delivery, intact and without incumbrance, to its ward.

It may be misleading to talk about this case as one of "implied tax exemptions", or to confuse it, as petitioner does, with taxability of annual fruits of the land. Indians are not exempt from tax on their income. When these petitioners are placed in possession of their land or its proceeds, free from the trust, they will then have a "basis" looking to the production of income over that basis in the future. Thereafter they may have capital-gain income, hence be taxed. But so far as this land is concerned (unlike non-restricted or non-trust lands which an Indian or anyone else might purchase) respondents have not yet received their capital upon which to make a gain.

3. The talk of continuing importance of this case in the light of an estimated 13,600,000 acres of restricted, allotted lands from which the income is substantial would not apply to respondents' case or to respondents' income or that of other Indians situated as are respondents. If that importance warrants review, then such a case, just decided, as *Nicodemus v. United*

[4] Income actually received by a *competent* Indian stemming from oil-and-gas leases.

[5] State gross-production tax on *lessees*, not Indians, even the dictum cited referring only to oil royalty income.

[6] State inheritance tax.

States (N. Div. Ida., June 15, 1955), 1955 P-H Tax Service, ¶ 72,786, involving ordinary income from trust or restricted land in the form of rents and grain (*fructus industriales*) would be a more likely target of a petition. Oil and gas bonuses, rents and royalties from leases are not in point, as we showed above. And any great proceeds from sales of land in the guise of standing timber of Indian allottees must be substantially confined to the Olympic Peninsula, hence to the Ninth Circuit—but in any event, even were that not so, should await the occasion of a conflict, if ever one arises.

CONCLUSION

There is no conflict of decisions among the circuits and there is no continuing importance in the case sufficient to warrant granting the writ, which accordingly should be denied.

Respectfully submitted,

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